

Before the
POSTAL REGULATORY COMMISSION
Washington, DC 20268-0001

Statutory Review of the System :
for Regulating Rates and Classes : Docket No. RM2017-3
for Market-Dominant Products :

REPLY COMMENTS OF THE GREETING CARD ASSOCIATION

The Greeting Card Association (GCA) files these comments pursuant to Order No. 4258. GCA filed comments in response to Order No. 3673, the advance notice of proposed rulemaking, and initial comments in the present phase of this Docket.¹ The views expressed in those comments still represent GCA's position but will not be reiterated *in extenso* in this filing, the purpose of which is to respond to proposals and arguments advanced in initial comments.

PRICE CAP ISSUES

I. COMMENTERS SUPPORTING PROPOSED RATEMAKING CHANGES OR
ADVOCATING LARGER REVENUE INCREASES IGNORE COMPETITIVE PRODUCTS' CONTRIBUTION

GCA's Initial Comments included extensive discussion of the importance of competitive products in bolstering the Postal Service's finances, and of how Order No. 4258 essentially ignored that factor, placing sole responsibility for restoring medium-term financial stability on market-dominant mailers.² The Alliance of Nonprofit Mailers and others have provided additional, highly useful discussion along the same lines, as have

¹ *Initial Comments of the Greeting Card Association* (March 20, 2017) (GCA 2017 Comments); *Initial Comments of the Greeting Card Association* (March 1, 2018) (GCA Initial Comments).

² GCA Initial Comments, pp. 3 et seq.

the National Postal Policy Council and other parties.³ Some other initial comments, either partially supporting the Order 4258 proposals or labeling them inadequate, exhibit the same shortcoming identified in our comments and in those of the other participants just mentioned. Here we discuss two prominent examples.

A. The Postal Service position

The Postal Service argues that the proposed two percent supplemental rate authority will not result in medium-term financial stability.⁴ It views this as the set of “going-in” rates and calls it “woefully inadequate.” It considers this separately from the “going-forward formula” – i.e., the continued CPI-U price cap – and condemns the latter as too rigid to allow it to become financially secure. The Service criticizes the Commission for not recognizing, in designing the cap, its limited ability to reduce costs or the decline in market-dominant volume, to which it ascribes a “large and growing revenue shortfall.”

To support this argument, the Service provides, in its Appendix B, a set of scenarios purporting to show that the Commission’s proposals will not suffice for financial stability. This Appendix is constructed throughout on the basis of market-dominant revenue, shown as \$47.8 billion (FY 2017). The first page (“Baseline Loss and Estimated One-time Supplemental Rate Authority”) presents several calculations, each of which arrives at an “Equivalent one-time supplemental rate authority” ranging from 10.4 to 12.5 percent of FY 2017 market-dominant revenue.

Nowhere does this argument recognize that, in FY 2017, competitive mail and services brought in \$20.824 billion and contributed \$7.152 billion to institutional costs.

Scenario 3 on the first page of Appendix B represents the largest estimated five-year average loss -- \$6.0 billion. Like the rest of the Appendix, it considers only market-

³ *Comments of Alliance of Nonprofit Mailers, American Catalog Mailers Association, Inc., Association for Postal Commerce, Idealliance and MPA – The Association of Magazine Media (ANM et al.), pp. 71-75; Comments of the National Postal Policy Council, the Major Mailers Association, and the National Association of Presort Mailers (NPPC et al.), pp. 53-55.*

⁴ *Initial Comments of the United States Postal Service in Response to Order No. 4258 (USPS Initial Comments), pp. 52 et seq*

dominant revenue⁵, and calculates a pro forma one-time revenue enhancement on that basis.

Order No. 4258 at least recognized that competitive products do contribute to the Postal Service's financial stability. However, it did so only on the basis of an arbitrary, unsupported, and most probably wrong assumption that their contribution would remain flat for five years after a history of increases, and thereby concluded – equally arbitrarily – that market-dominant mailers must bear the entire burden of restoring medium-term stability.

The Postal Service's position is even more at odds with reality. It flatly, and without explanation, ignores totally the nearly \$21 billion in FY 2017 competitive-sector revenue (to say nothing of the history of competitive income growth⁶), in order to argue that market-dominant mailers, and only they, should be taxed much more heavily than the Commission proposed.

This one-sidedness pervades the Postal Service's comments. One example is its argument that the Commission's performance-based additional rate authority should be replaced by an unconditional capital funding mechanism, modeled on one devised by the Alberta Utilities Commission for electric and gas distribution utilities (a "K-Bar").⁷ The Service explains this mechanism, and why it considers it much more satisfactory than the Commission's proposal. What it does not explain is how far the funds it made available would be used to strengthen and expand its competitive business, and why market-dominant mailers should be taxed for that purpose.⁸

⁵ Some of the adjustments used in arriving at these estimates may be legitimately associated with the market-dominant sector: the exigent surcharge affected only market-dominant products, and likewise the PIHOP adjustment. But removing the non-cash workers' compensation liability change clearly is not: some portion of workers' compensation liability must be ascribed to cases involving competitive products.

⁶ See GCA Initial Comments, pp. 28 et seq. and Appendix A.

⁷ USPS Initial Comments, pp. 90 et seq.; the Alberta scheme is described at pp. 92 et seq. It is not clear from the Postal Service's description whether the electric and gas utilities in question have both monopoly and competitive (unregulated) lines of business.

⁸ The Postal Service cites Postmaster General Brennan's testimony before the House Oversight and Government Reform Committee, 115th Congress, at its hearing on H.R. 756 (id., p. 91, fn. 222). Reference to pp. 5-6 and 7 of the Postmaster General's written statement strongly suggests that investment in competitive products could be very substantial.

It bears repeating that the entity whose financial stability is in issue is the entire Postal Service – not an imaginary Market-Dominant Postal Service insulated from the growing, profitable array of competitive products. The net losses posited as the basis for the Postal Service’s attacks on Order 4258 are losses for the entire system. To point to them while excluding from consideration a large and increasing block of income is incoherent. By enacting the Postal Service’s scheme the Commission would thwart, rather than improve, the system’s compliance with the statutory objectives.

B. The Public Representative’s proposed changes to the price cap

Unlike the Postal Service, the Public Representative (PR) advocates retention of a price-cap system. His proposed modifications, however, exhibit serious shortcomings. In this section, we consider the failure of the PR’s comments and their supporting Declarations to recognize the contribution of the competitive sector to the Postal Service’s financial well-being.

The PR’s comments do not mention the competitive products or their financial contribution. In the heading for section III.C.2, the PR criticizes the Commission’s five-year, two-percent supplemental rate authority as “Not Based upon Reasonable Consideration of All Relevant Factors.” His proposal is no better. More than \$20 billion in revenue and \$7 billion in contribution to institutional costs are clearly “relevant factors” in assessing, and deciding how to improve, the Postal Service’s financial condition. The PR ignores them.

Exogenous costs. This omission affects the PR’s presentation at the more detailed level too. The Declaration of Drs. Kwoka and Wilson argues that the price cap should include an explicit Z-factor to allow the Service to recover – separately from the CPI-based cap increase – its outlays for RHB pre-funding, Federal Employees Health Benefits (FEHB), and pensions (CSRS and FERS). Leaving aside, for the present, the question whether any of these costs should be reflected dollar-for-dollar in the cap structure, it must be pointed out that they relate to *all* Postal Service employees and retirees. They are not uniquely costs of the market-dominant sector.

For example, in FY 2017 City Carrier Network Travel (Cost Segment 7.1, Component 54) was a \$495 million cost item, 100 percent institutional.⁹ Carriers' network travel clearly subserves both market-dominant and competitive products. These carriers generate RHB, FEHB, and pension costs. The PR's proposal is thus misconceived in two respects: it would burden market-dominant mailers with all these costs, and it would fail to recognize that – to use the example above – the \$7 billion in competitive contribution helps pay for the \$495 million of purely institutional network travel costs.

The PR's argument depends significantly on the proposition that these "exogenous" costs are not controllable by the Postal Service. Accepting that proposition *arguendo*, it does not follow that they should be recovered entirely through market-dominant prices. Laying down a rule that monopoly customers should pay them all, even in the presence of multi-billion-dollar revenue and contribution results on the competitive side, subverts not only the underlying rationale of incentive regulation but also some specific objectives of PAEA.

To the extent that these costs are not attributable, objective (b)(9) is relevant. An appropriate allocation of institutional costs between the market-dominant and competitive sectors is impossible if the experienced, and predictable, revenue and contribution of competitive products are ignored. Sec. 3633(a)(3), after all, requires that the competitive sector pay for an appropriate share of institutional costs, and the Commission has recently (Order No. 4402) proposed a new method of determining what it should be. The PR's suggested Z-factor ignores this contribution, and consequently subverts objective (b)(9) which, independently of the appropriate-share requirement, calls for a proper allocation of institutional costs between the competitive and market-dominant sectors.

Objective (b)(8) is also implicated. "Just" rates – by the Commission's definition, rates not excessive for customers – are similarly impossible if market-dominant mailers must pay all the institutional portion of these exogenous costs while none is recovered from competitive customers.

⁹ Docket No. ACR2017, *Public Cost Segments and Components Report*. By using this example, we are not suggesting that network travel cost is in fact attributable to products; our point is simply that the delivery function responsible for it is required by competitive and market-dominant products alike.

Volume decline. It might be argued that even if RHB pre-funding and similar costs are not properly recovered through market-dominant rates alone, the other exogenous factor cited by the PR – volume decline – *is* a market-dominant phenomenon and so an appropriate ground for adding a Z-factor to the price cap. But here, the PR’s proposal ignores a particularly important objective: maximization of incentives for improved efficiency and cost reduction (objective (b)(1)). The Kwoka-Wilson Declaration contains this accurate generalization:

. . . Price cap regulation seeks to harness the firm’s natural profit-maximizing incentives to adopt best practices and lower costs, by breaking the tight connection between price and the firm’s realized profit at any point in time. For example, if the price that the firm can charge for a product were completely independent of its costs or profits, then all cost savings would flow directly into its profits and the firm would have the strongest possible incentive to reduce its costs. On the other hand, if price gets adjusted too quickly relative to costs, the firm’s profit incentive is greatly reduced.^[10]

Ten pages later, however, the same Declaration calls for a declining-volume Z-factor which ignores the cost-reduction incentive:

Since exogenously declining mail volumes increase average unit costs, the price cap formula should include a term that adjusts price annually by the amount of the average cost increase resulting from declining volumes.^[11]

This proposal, in other words, would very likely adjust price “too quickly relative to costs.” It ignores the pro-efficiency objective, which Drs. Kwoka and Wilson recognize as central to the theory of price caps. It does not suggest that the application of the Z-factor should depend on some degree of reduction in average costs. The Z-factor – as described in detail in Dr. Brennan’s supplemental declaration – simply indemnifies the Postal Service, dollar for dollar, for volume decline without providing any motivation to control the average costs which the decline is assumed to increase.

¹⁰ *Declaration of John Kwoka and Robert Wilson*, p. 7.

¹¹ *Id.*, p. 17.

Another questionable feature of Dr. Brennan's proposal is the additional adjustment for price-induced volume loss. He acknowledges that his first-stage volume adjustment assumes that the price increases it causes will not affect volume, and that this is unlikely to be true.¹² He therefore incorporates Postal Service price elasticity estimates into the formula. He does not, however, consider whether these estimates are sufficiently reliable for his purposes. In our March 2017 *Initial Comments*, Appendix C, we showed that they are not dependable for predictive purposes: inconsistencies in model design and product definition cause them to vary substantially from year to year. Incorporating them in the proposed formula not only makes its results unreliable but would hinder achievement of objective (b)(2) (stable and *predictable* rates).

Dr. Brennan also appears not to have inquired whether a cross-price elasticity exists between First-Class mail and the e-media he states are siphoning off volume. If it does, the own-price elasticities he uses are not the only price-driven causes of volume decline. In that event, his formula would not achieve what he intends it to.

Finally, the question of increasing average cost due to volume decline brings us back to the PR's failure to consider the effects of competitive products. Dr. Brennan's *Supplemental Declaration* in the present phase of this Docket suggests that the costs, revenues, and elasticities he uses are not system-wide but are specific to market-dominant products. But it is the Postal Service as a whole whose financial stability is at issue. The PR's proposed changes would place the entire burden of restoring it on market-dominant mailers. The Commission cannot adopt these changes without failing in its obligation to cause the market-dominant ratemaking system to achieve more fully the statutory objectives.

II. THE COMMISSION'S FINDING THAT THE PAEA SYSTEM HAS ACHIEVED SHORT-TERM FINANCIAL STABILITY IS CORRECT

While this question is perhaps broader than the price cap issue, it can be dealt with here in view of the close connection between them. In Order No. 4257, the

¹² *Supplemental Declaration of Timothy J. Brennan for the Public Representative*, pp. 4 et seq.

Commission concluded that the PAEA ratemaking system had achieved short-term financial stability. The Public Representative attacked this finding in an unsuccessful motion for reconsideration¹³, and makes a similar argument in his initial comments. The Postal Service likewise argues that the system has failed to produce even short-term stability. The Commission has dealt with similar arguments in denying the PR's motion.

A. The Postal Service position

In opposing the Public Representative's motion for reconsideration, GCA and the National Postal Policy Council (NPPC) pointed out that

. . . if the short-term stability finding sounds, to the Public Representative, "more like insolvency" it does so only because he ignores the distinction between *short-term* financial stability and financial stability *tout court*.¹⁴

The Postal Service also ignores it. The Service argues that short-term financial stability, as the Commission defined it, is not the same thing as financial stability, and that it is not "a comprehensive measure of financial stability that can justify binding legal determinations as to the achievement of objective 5."¹⁵ But the Commission, as it made clear in Order 4257, did not mean it to be. Short-term stability is one of three components in the Commission's overall analysis. The Commission's *overall* conclusion – that objective (b)(5) has not been achieved because neither medium- nor long-term stability has been, is consistent with the Service's view of that objective. The statutory language does not call for the achievement of "short-term and medium-term and long-term financial stability," as three separate desiderata. The Postal Service has confused an analytical technique, devised by the Commission to make the objective (b)(5) investigation

¹³ *Motion by the Public Representative for Reconsideration* (January 5, 2018). The motion was denied on the merits in Order No. 4398.

¹⁴ *Answer of Greeting Card Association and National Postal Policy Council to Public Representative's Motion for Reconsideration* (GCA-NPPC Answer), p. 4.

¹⁵ *Initial Comments of the United States Postal Service in Response to Order No. 4258* (Postal Service Initial Comments), p. 14 (fn. omitted).

more manageable, with a comprehensive legal conclusion as to whether that objective has been met.¹⁶

This issue should not be confused with the question whether the proposals in Order No. 4258, taken as a whole, provide enough financial support for the Service. The Postal Service has, however, not justified any change in the Commission's conclusion as to short-term financial stability.

B. The Public Representative's argument

The Public Representative largely repeats the arguments offered in his motion for reconsideration. They are somewhat intertwined with a quite separate contention¹⁷ that the measure proposed in Order No. 4258 would operate *too late* to achieve short-term stability; here, we will focus only on the issue of whether the Commission's short-term finding is correct.

The PR argues that "[o]bjective 5 is not limited to consideration of 'positive adjusted operating profit' or to the ability 'to operate continuously without interruption.'"¹⁸ But the Commission has not said that it is, nor does its treatment of objective (b)(5) imply that it thinks so. Again, the PR has failed to distinguish between an analytical tool the Commission has used in examining the adequate-revenue issue and an overall conclusion as to whether the existing ratemaking system has achieved financial stability.¹⁹

¹⁶ This is, of course, a separate issue from that raised by participants who believe the Commission was wrong to find that medium- and long-term financial stability had not been achieved, and are pursuing that question in the Court of Appeals. See the Petition for Review in D.C. Cir. No. 17-1276, *National Postal Policy Council v. Postal Regulatory Commission* (Dec. 29, 2017).

¹⁷ *Initial Comments of the Public Representative* (PR Initial Comments), pp. 13-14.

¹⁸ *Id.*, p. 11.

¹⁹ The underlying assumption in his argument, and perhaps in the Postal Service's too, may be that "financial stability" is an unanalyzable notion which, given that the Commission has divided it for working purposes into short-, medium-, and long-term analyses, must therefore be achieved *identically* in the short, medium, and long terms, if it is to be achieved at all. That is, the standards for short-term stability are assumed to be exactly the same as those for financial stability as a whole – short, medium, and long terms together. If this were true, it would have been pointless for the Commission to divide its analysis into short-, medium- and long-term sub-inquiries – which the PR, at least, concedes is within the Commission's authority (PR Initial Comments, p. 11).

Again, with respect to the issue of cash reserves, the PR argues that

There has been no demonstration that Objective 5 contemplates reliance on inadequate investment and defaulted legal obligations as a basis for achieving financial stability.^[20]

We observed in responding to the PR's reconsideration motion that "there is clearly no logical error in stating that an entity can hold enough cash for short-term purposes by not meeting obligations that do not have to be met in the short term."²¹ The Commission's finding that it can is not an ultimate conclusion on whether the system has produced financial stability – which is what objective (b)(5) and sec. 3622(d)(3) require of it, and which it set forth, as a "no," in Order 4257.

III. THE POSTAL SERVICE'S "ALTERNATIVE" SYSTEM WOULD FAIL TO ACHIEVE THE OBJECTIVES OF PAEA

In this section, we discuss some critical aspects of the Postal Service's proposal to abolish the price cap in favor of a system combining *ex post* review by the Commission of rates established by the Service with a structure of "forward guidance" claimed to provide postal customers with sufficient predictability. GCA believes that the proposed alternative system would signally fail to protect postal customers from excessive rates, and would not even provide the predictability claimed for it.

A. The proposed *ex post* supervision would be ineffective

The Postal Service argues that *ex post* supervision would provide sufficiently effective protection for postal customers. It would not, largely because of 39 U.S.C. sec.

²⁰ PR Initial Comments, p. 12.

²¹ GCA-NPPC Answer, p. 4.

3681 – inherited from the 1970 Postal Reorganization Act – which this review cannot change.²²

Sec. 3681 reads:

No mailer may be reimbursed for any amount paid under any rate or fee which, after such payment, is determined to have been unlawful after proceedings in accordance with the provisions of sections 3662 through 3664 of this title, or is superseded by a lower rate or fee established under subchapter II of this chapter.

If the Postal Service established a rate which the Commission, in after-the-fact review under sec. 3653, found non-compliant and ordered changed, its replacement would be established under subchapter II. Thus under the second branch of sec. 3681, mailers would obtain no relief for an unlawful rate set by the Postal Service which they had paid initially, during the Commission's after-the-fact review of it, or while the replacement rate was being put in place. The same would be true if the finding of non-compliance resulted from a sec. 3662 complaint or from judicial action.

This situation contrasts sharply with the treatment of rates filed by a regulated firm in some more traditional ratemaking statutes. A fair example is the Natural Gas Act (15 U.S.C. sec. 717 et seq.). A natural gas company files rates of its own choosing, but the Federal Energy Regulatory Commission may suspend them while they are reviewed. The suspension may be as brief as one day, but the rates are allowed to go into effect *subject to refund* to the extent found unlawful. 15 U.S.C. sec. 717c(e). Sec. 3681 denies postal customers any such protection.

The Postal Service's March 2017 comments dismiss sec. 3681 in a footnote²³, arguing that it is not a reason to retain *ex ante* regulation since the Commission could

... fashion a prospective remedy to remedy any unlawful action by the Postal Service, which could include reduced pricing authority and the imposition of more burdensome regulation. As such, any effort by the Postal Service to take advantage

²² Sec. 3681 is not part of the system established under sec. 3622(a) and is thus excluded from the review mandated by sec. 3622(d)(3) and defined as to scope by Order No. 3673.

²³ Appendix F to USPS 2017 Comments, a report by Christensen Associates discussing regulatory models in detail, does not mention sec. 3681.

of Section 3681 would constitute only a short-term gain, which the Postal Service would know would be far outweighed by the longer-term repercussions.^[24]

This does not resolve the problem. A *prospective* remedy, even if fully effective, does nothing to help the mailer already damaged by the unlawful rate. Even “reduced pricing authority” can only be forward-looking. For example, suppose that the Commission finds, after the fact, that rate X was 20 percent too high, and reduces the Service’s pricing authority as to that rate by 20 percent, going forward. No refund of the 20-percent excess is available. In principle, it would even be possible for the Service to raise rate X again in violation of the PRC order. (We can agree that the Postal Service would almost certainly not do so; but that such an action is theoretically possible demonstrates the weakness of its proposal.) In the hypothesized situation, the affected mailers then have two options: (i) file a sec. 3662 complaint, (ii) or, proceeding under sec. 3664, ask a District Court to enjoin the violation. Suppose, further, that the Commission or District Court, after the required proceedings, agrees with them. In either case, the proceeding takes time. The result is, to use the Service’s term, another “short-term gain,” and, necessarily, a further unreimbursable loss for the mailers.

The Postal Service’s proposed after-the-fact review scheme would thus interfere with, rather than promoting, objective (b)(8), by creating a serious risk of unjust rates for which no after-the-fact remedy would exist. The language of objective (b)(8) does not call for a “just and reasonable” schedule of rates just some of the time; on the contrary, it requires the system to “establish *and maintain*” such a rate schedule.

The potential for unreimbursable excess charges would also weaken the incentives to efficiency called for by objective (b)(1). The proposed scheme would fail to promote objective (b)(2), since the future shape of any questionable rate would depend on a Commission proceeding, possibly followed by judicial action.

²⁴ *Comments of the United States Postal Service* (March 20, 2017) (USPS 2017 Comments), p. 219, fn. 428.

The Postal Service does include a mechanism – a system of “forward guidance” as to its prospective rate changes – which it believes would promote predictability. We discuss that next.

B. The claimed Federal Open Market Committee analogy is defective

The Postal Service argues that the forward guidance mechanism employed by the Federal Open Market Committee (FOMC) of the Federal Reserve shows that the corresponding aspect of its alternative system would effectively protect postal customers. The analogy is misleading: the FOMC forward guidance mechanism has a completely different purpose from that envisioned by the Service’s proposal, and its effectiveness does not suggest that the latter would be equally successful.

The Service’s proposed forward guidance mechanism would provide information on what it expected to charge for its own products. The FOMC forward guidance system does no such thing; it is meant to influence the future behavior of financial markets. It is described in *Statement on Longer-Run Goals and Monetary Policy Strategy*, most recently updated in January of this year.²⁵ FOMC notifications of anticipated monetary policy actions are meant to control inflation and, more indirectly, deviations from what it considers the maximum desirable level of employment. The Federal Reserve’s budget, unlike the Postal Service’s, does not depend on sales of products or services. That the FOMC’s forward guidance may be effective in promoting its goals does not imply that the Postal Service’s proposal would be equally effective in promoting its very different ones.²⁶

For example, an unexpected change in discount rates could quickly inflate the Postal Service’s workers’ compensation cost.²⁷ The proposal clearly allows for departures from the forward guidance in such situations. The plan described in the Service’s

²⁵ Available at www.federalreserve.gov/monetarypolicy/files/FOMC_LongerRunGoals.pdf.

²⁶ The Postal Service proposal is described at USPS 2017 Comments, pp. 203 et seq.

²⁷ Example: see USPS Initial Comments, p. 58. That change reduced the Service’s liability, but an equally large and sudden change obviously could have the opposite sign,

March 2017 comments allows for deviations at nine, six, and three months before implementation. The Service has a direct motivation to make such deviations whenever unexpected financial events put its stability at risk.

By contrast, the FOMC has a greater interest in making its forward guidance credible. The Postal Service observed in its March 2017 comments that

. . . market participants will not conform their actions to forward guidance if they do not believe that it will be adhered to. The FOMC establishes credibility and increases the effectiveness of forward guidance by being consistent with the assurances contained therein, *even when deviation from those assurances would be more beneficial in the short-term.*^[28]

The Postal Service, faced with an unanticipated imbalance between costs and revenues, has, at least, a far weaker interest in forgoing short-term benefit in the interest of making its forward guidance more credible. For that reason, the proposed forward guidance cannot be expected to do all that the Service claims for it to make rates predictable. And It is not clear that it would do anything whatever to make rates more stable. A forward guidance mechanism may achieve a high degree of credibility even if the rate changes it (accurately) predicts gyrate wildly.

C. The Postal Service's complaints that some comments have not been adequately recognized are premature

At pp. 36 et seq. of its March 1 comments, the Postal Service asserts that Order No. 4258 did not adequately reflect comments advocating abolition of the price cap in favor of an alternative regulatory model.²⁹ On p. 37, the Service quotes a few lines from Order 4258, interprets them, and goes on to say that “. . . Order No. 4258 contains no other explanation or justification for rejecting the Postal Service's proposal, apart from this sparse reference to objective 2.” To put it simply, the Postal Service objects to the Commission's having proposed something drastically different from what the Service

²⁸ Id., p. 204 (fns. omitted; italics added).

²⁹ It cites its own March 2017 comments and those of the National Association of Letter Carriers, the American Postal Workers Union, and the National Postal Mail Handlers Union. USPS Comments, p.36, fn. 87.

had urged it to propose, and, in the process, to have given insufficient heed to its comments and those supporting its view.

Arguments of this kind are appropriate, and can be successful, when made against an agency's final order. They are out of place here. The Commission has issued a notice of *proposed* rulemaking, with supporting findings, and invited comments on its proposals. Some of those comments, like the Postal Service's and to some degree our own, are highly critical of what the Commission has proposed (though the points of view they express may be diametrically opposed). But if an agency that, like the Commission, has previously issued an *advance* notice of proposed rulemaking explicitly meant to assist it in preparing a subsequent notice containing actual proposed rules, commits legal error by not including in that second issuance all the suggestions made in response to the advance notice, it is hard to see how a rulemaking could move forward. This is particularly clear when, as here, the comments responding to the advance notice urge incompatible courses of action. The Postal Service then proposed, as it still does, to do away with the price cap entirely. GCA argued that the Commission does not even have statutory authority to do so, and in any case should not, as a policy matter. If the Commission had been in error in not adopting the Service's abolition scheme as the basis of its proposed rules, the same reasoning implies that it was equally wrong in not agreeing with GCA that the price cap is essentially untouchable. And the same dilemma would exist if the supposed error lay in not having fully explained why the party's proposal was not adopted.

The problem is simply that the standard of reference and explanation that the Service wishes to impose is appropriate for a final order, but not for a notice of proposed rulemaking.

The case law the Postal Service cites at p. 36, fn. 88, uniformly speaks of *final* agency decisions. It is true enough that a final rulemaking order must draw proper connections between the rules adopted and the facts found, and must not omit significant issues or disregard substantial comments. We assume that the Commission, when it does issue final rules in this Docket, will respect those principles. But it is entirely premature to argue now that the notice of proposed rulemaking should have justified – as

though it were a final order – the decision not to propose the Service’s alternative system.

OTHER ISSUES

IV. INBOUND INTERNATIONAL MAIL SHOULD REMAIN SUBJECT TO THE PRICE CAP

The Postal Service urges the Commission to reconsider that aspect of Order No. 43 which retained Inbound International Letter Post as part of the price-capped market-dominant ratemaking system.³⁰ It argues that because UPU terminal dues rates control the price of this product, it cannot; and that variations in them can either inflate or diminish its pricing authority, depending on the relationship between them and the rate of inflation.

These arguments, considered abstractly, are not unreasonable. Unfortunately, they cannot be evaluated abstractly but must be looked at in light of the actual situation regarding inbound international letters. We can agree that the problem as the Postal Service presents it results largely from the UPU’s rate-setting approach, which the Service, under the UPU’s one-nation-one-vote system, can do little to influence. That fact, however, does not diminish the Commission’s responsibilities.

The market-dominant ratemaking system, by virtue of sec. 3621(a)(10), includes single-piece international mail. This is not a definition the Commission can change, since it is not part of the system established under sec. 3622(a) and subject to the present review under sec. 3622(d)(3). We do not understand the Postal Service to argue otherwise.³¹ The question then becomes: can such a market-dominant product be removed, by Commission action, from the market-dominant ratemaking system?

³⁰ USPS Initial Comments, pp. 153 et seq.

³¹ In Docket RM2007-1, the Postal Service argued that sec. 407 created separate regulatory mechanisms for this mail, making the market-dominant ratemaking system inapplicable to it. In Order No. 43, the Commission rejected this argument.

GCA would suggest that it cannot. First, sec. 407(c)(1) requires the Commission to provide the Secretary of State with its views as to whether “any treaty, convention, or amendment that establishes a rate or classification for a product subject to subchapter I of chapter 36” is consistent with the standards the Commission established under section 3622 – that is, the market-dominant ratemaking system. By statutory definition, inbound single-piece international mail is subject to subchapter I. Consequently, if a “treaty, convention, or amendment” establishes a rate for it, the Commission is obliged to furnish an opinion to the Secretary as to whether that rate passes muster under the (then current) rules for market-dominant rates. The statute does not seem to permit the Commission to negate this obligation by “removing” inbound international single-piece mail from the price cap.

It is true that for the most part the Commission can allow the Postal Service to transfer a product from the market-dominant list to the competitive list (sec. 3642(a)), but it may not do so with respect to a product subject to the statutory monopoly (sec. 3642(b)(2)), which would include letters regardless of country of origin. For that reason, sec. 3642 could not be used to remove inbound international letters from the price cap, because they may not be transferred to the competitive list, and no (non-experimental) product may be handled unless it belongs to one of the two product lists (sec. 3642(e)).

In our March 2017 comments, we observed at p. 35 that

. . . [D]esignation of the price cap as a “requirement” means that all [market-dominant³²] rates are, as a matter of law, governed by the cap. There being nothing contingent about the existence of rates, and no exceptions to their being subject to the price cap, it follows that being governed by the cap is part of the definition of “rate.” In other words, that any rate we choose to examine is governed by the price cap is an analytic proposition. Its truth is guaranteed by the meaning of its terms, in the same way that the truth of “This triangle has three sides” is guaranteed by the meaning of its terms.

This leads us to conclude that inbound international single-piece mail rates cannot be removed from the price cap.

³² Footnote 40 on the page quoted specified that only market-dominant rates were being discussed.

It is true, as the Postal Service's argument implies, that the UPU system of rate-setting conflicts with that established by the Commission under sec. 3622. The principal difficulty, however, seems to GCA to be that the UPU rates may not allow the Service to cover the attributable costs of the mail subject to them. This is not, however, a reason to exclude inbound international single-piece mail from the price cap altogether. The Postal Service points out³³ that the Commission's proposed rule 3010.201 would require it, in that event, to devote additional cap space to that product. If that proposed rule were refined to allow for cases where the Service in fact cannot influence the rate, this problem would be alleviated.

There is another practical reason for the Commission to refrain, at least at this point, from attempting to change the price-cap status of inbound international letters: the apparent existence of controversy over whether the Postal Service is in fact subject to UPU rate limitations. On November 8, 2017, the Commission received a copy of a letter, addressed to the Secretary of State and the Postmaster General, from Rep. Kenny Marchant and several other Members of Congress, raising that legal issue. The letter voices concern over the effects on domestic postal customers of the lower rates available to their foreign competitors³⁴, and states that

. . . [A] recent letter from the U.S. Department of State, dated July 27, 2017, confirms that "[t]he United States has not formally approved the 2012 UPU Convention." Moreover, it confirms that the United States has not formally approved a UPU Convention since the 2008 Convention, which ceased to be in force on December 31, 2013. It appears, therefore, that as a matter of international law, neither the United States nor the Postal Service is under an obligation to deliver foreign postal shipments at rates that are less [than] the Postal Service would charge domestic mailers for comparable services.

GCA expresses no opinion as to whether the letter is correct as a matter of international law, or on how the question should be resolved. One potential resolution – that suggested in the Marchant letter – would negate the issue entirely. Our point, accordingly,

³³ USPS Initial Comments, p. 155.

³⁴ Similar concerns were expressed in Chairman Taub's June 16, 2015, testimony before the House Government Reform and Oversight Government Operations Subcommittee and in the Copenhagen Economics report cited therein.

is simply that until the controversy is resolved, the price-cap status of inbound international mail should not be disturbed.

V. THE COMMISSION'S PROPOSED TFP METRIC SHOULD BE REFINED

Order No. 4258 proposes that the Postal Service's progress in improving its Total Factor Productivity (TFP) trigger the availability of the 0.75 percent performance-based additional rate authority. GCA believes that an incentive soundly based on productivity improvement could be worthwhile. The proposed mechanism, has a significant flaw which should be corrected if the Commission decides to proceed along these lines.

Separate market-dominant and competitive TFP measures. The problem was pointed out by United Parcel Service (UPS).³⁵ The Commission's proposal uses system-wide TFP and allows the additional rate authority to apply if it has improved by 0.606 percent or more, measured over the preceding five years. As UPS points out, "the Postal Service could be rewarded with supplemental market dominant rate authority by improving the efficiency of the competitive products business."³⁶ The pro-efficiency incentives built into the market-dominant ratemaking system, via objective (b)(1), are not achieved if the efficiency gains actually experienced are predominantly or entirely on the competitive side. Indeed, objective (b)(1) is subverted if the additional rate authority for market-dominant products is generated by efficiency gains which do not benefit them; the extra revenue simply allows for *less* efficient conduct of the market-dominant business.

Blurring the distinction between efficiency improvements on the market-dominant side and those in the competitive sector is also inconsistent with objective (b)(6) (improved transparency in ratemaking). The Commission would be flying blind if it allowed the Service an additional 0.75 percent market-dominant rate authority without knowing

³⁵ *Comments of United Parcel Service, Inc.*, pp. 5 et seq.

³⁶ *Id.*, p. 6. The Commission should consider whether such a result is made more likely by the contrasting volume trends in the two sectors: downward in market-dominant mail, and upward in competitive products. The changing scale of operations in both cases could affect the efficiency of either.

whether the underlying efficiency improvements occurred in the market-dominant sector.

The Commission, accordingly, should adopt UPS's proposal to require separate TFP measures for the market-dominant and competitive sectors, and condition availability of the extra 0.75 percent rate authority on the achievement of the requisite efficiency gain in the market-dominant sector alone. The mechanism could be refined further by making the same separation retrospectively, for the period of years in which the Postal Service's competitive traffic recorded marked increases. If that inquiry showed a substantial difference in productivity improvement, as between the competitive and market-dominant sectors, it could usefully clarify whether sufficient investment and innovation are occurring on the market-dominant side. This information would help the Commission assess how well, or poorly, objective (b)(1) of the market-dominant ratemaking system is being achieved.

CONCLUSIONS AND RECOMMENDATIONS

1. The Commission's proposals in Order No. 4258, and certain comments significant because of the major changes in the Commission's approach which they suggest, all exhibit, in varying degrees, the same disabling deficiency: they ignore the important contribution of the Postal Service's profitable and growing competitive business to its financial stability. As a result, all these proposals would place the entire burden of repairing the Service's finances on market-dominant customers.

2. This situation would clearly violate objectives which this review is designed to promote. A rate schedule which, by ignoring \$21 billion in competitive revenue and \$7 billion in contribution, makes market-dominant mailers responsible for restoring the Service's finances is not just and reasonable (objective (b)(8)). It would not appropriately allocate institutional costs between the two sectors (objective (b)(9)). If the added burden on the market-dominant sector did produce extra revenue – that is, if the excessive rates did not drive out so much volume as to *reduce* revenue – the pro-efficiency incentives which objective (b)(1) is to promote would be diluted.

3. Of the initial comment proposals which would defeat rather than promote the statutory objectives, the Postal Service's are the most damaging. The Commission and the PR at least recognize the need to retain a price cap. The Commission should begin the next phase of its deliberations by discarding the Postal Service's *ex post* review scheme in toto. First, it ignores revenue and contribution from competitive products. It would leave market-dominant mail users remediless for the substantial time needed to correct unlawful rates, since sec. 3681 prohibits reimbursement. And the proposed forward guidance mechanism would probably produce materially less predictability than the Postal Service claims for it.

4. The PR's proposed modifications to the price cap should be rejected. Like the Postal Service, the PR ignores the contribution – to institutional costs in particular, and to overall financial stability – of the large and growing competitive sector. The proposed Z-factor for exogenous costs would tax market-dominant mailers for the entirety of the exogenous institutional cost, violating objectives (b)(8) and (b)(9). The Z-factor for declining volume likewise ignores competitive product growth, as well as the need to incentivize efficiency improvements (objective (b)(1)), and, since it incorporates price elasticity estimates which have varied substantially from year to year, interfere with predictability and stability of prices (objective (b)(2)).

5. The Commission should retain Inbound International Letter Mail (and the associated special services) under the price cap. GCA believes that it cannot lawfully be removed, but in any event, with the binding status of the UPU rates in question, it should not be disturbed until that controversy is resolved.

6. If the Commission proceeds with the proposed performance-based additional rate authority, it should bifurcate the TFP metric, develop separate measures for market-dominant and competitive sectors, and base availability of the extra rate authority solely on performance on the market-dominant side. Market-dominant mailers should not be taxed to reward the Postal Service for efficiency improvements that help only its competitive product customers.

March 30, 2018

Respectfully submitted,

GREETING CARD ASSOCIATION

David F. Stover
2970 S. Columbus St., No. 1B
Arlington, VA 22206-1450
(703) 998-2568
(703) 998-2987 fax
E-mail: postamp02@gmail.com